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THE TRUST FUND DOCTRINE AS TO THE CAPITAL STOCK OF CORPORATIONS.—The "trust fund" or "American" doctrine that the assets of a corporation are a trust fund for the payment of creditors and may be followed into any hands save those of a bona fide holder for value, was first laid down by Mr. Justice Story in the case of *Wood* v. *Dummer*.[1] In that case, a bank divided about two-thirds of its assets among its shareholders, leaving an amount insufficient to satisfy its creditors. In holding that the shareholders were liable up to the amount distributed to them, the decision was certainly correct; but obviously there was no necessity for invoking such a doctrine. The true ground should have been the old and familiar principle of fraud on creditors. Justice Story claimed to have found a basis for this doctrine in the early English chancery case of *Curson* v. *African Co.*;[2] but this case goes no further than to hold that equity will aid the creditor of a corporation as readily as the creditor of a natural person if he has no adequate remedy at law, and it can hardly be said to warrant the conclusion that the assets of a corporation are a trust fund for the benefit of its creditors.

The doctrine was taken up by the courts as a new discovery by which all difficulties of the question of the extent of the liability of the assets of a corporation to its creditors could be solved. On the ground that the assets of a corporation were a trust fund for

[1] 3 Mason 308, Fed. Cas. 17944. [2] 1 Vern. 121.

the benefit of creditors, shareholders who by agreement with the company were to pay less than par for their stock were forced, at the suit of creditors, to pay the unpaid balance.[3] And under this same principle, assets withdrawn and wrongfully distributed among the stockholders,[4] or transferred or conveyed to third persons without consideration,[5] could be followed by the creditors. Carrying the supposed analogy further still, it was held that an insolvent corporation could not collusively prefer one creditor over others.[6] While some of these decisions are correct in their conclusions, and are sound law if based on the ground of fraud; yet the doctrine that the assets of a corporation, even if insolvent, are a trust fund can be sustained neither on reason and principle nor by the weight of modern authority. No English case can be found to support the doctrine, and at least one directly repudiates it.[7] In *Hospes* v. *Northwestern Mfg. Co.*,[8] Judge Mitchell said:

> "Corporate property is not held in trust, in any proper sense of the term. A trust implies two estates or interests,—one equitable and one legal; one person, as trustee, holding the legal title, while another, as the *cestui que trust,* has the beneficial interest. Absolute control and power of disposition are inconsistent with the idea of a trust. The capital of a corporation is its property. It has the whole beneficial interest in it, as well as the legal title. It may use the income and profits of it, and sell and dispose of it, the same as a natural person. It is a trustee for its creditors in the same sense and to the same extent as a natural person, but no further."

An insolvent corporation may prefer certain creditors,[9] even

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[3] Sawyer *v.* Hoag, 84 U. S. 610; Upton *v.* Tribilcock, 91 U. S. 45; Sanger *v.* Upton, 91 U. S. 56.

[4] Bartlett *v.* Drew, 57 N. Y. 587.

[5] Conover *v.* Hull, 10 Wash. 673, 45 Am. St. Rep. 810.

[6] Conover *v.* Hull, *supra.*

[7] Directors guaranteed a loan for the corporation and judgment was recovered against them personally. They applied to the payment of the loan the amount of their unpaid subscriptions to stock, crediting themselves with paid up stock. This was attacked on the ground that they could not prefer one creditor over another but should hold for the benefit of all; that the capital stock was a trust fund for the creditors, and they were the trustees for all. *Held,* the directors were trustees for the company and not for the creditors, and that the creditors could not object to the payment of a debt for which the directors themselves were liable in preference to the debts of the company. Poole's Case, 9 Ch. Div. 322.

[8] 48 Minn. 174, 50 N. W. 1117, 31 Am. St. Rep. 637, 15 L. R. A. 470. Mr. Pomeroy in reference to the "trust fund" doctrine says: "It may be sufficiently accurate as a strong mode of expressing the doctrine that such property is a fund secretly set apart for the payment of corporate creditors before it can be appropriated to the use of individual corporators * * *. But it is plain that no constructive trust can arise in favor of the creditors." 23 POMEROY, EQ. JUR., 3d ed., §§ 1044, 1045.

[9] Shaw *v.* Robinson & Stokes Co., 50 Neb. 403, 69 N. W. 947; Ford *v.* Hill, 92 Wis. 188, 66 N. W. 115.

though the preferred creditor be a director in the insolvent corporation, if its claim is for a bona fide debt.[10] Such a power is totally foreign to the power of a trustee in the administration of a trust fund. A simple contract creditor cannot come into equity to enforce an unpaid stock subscription until he has exhausted his legal remedies.[11] This requirement is hardly consistent with the theory that the capital stock of a corporation is a trust fund for the benefit of its creditors. When the corporation is in failing circumstances, it can sell the stock for what it will bring on the market, or pay for labor with it at its real valuation and the buyer will not be liable to creditors for the difference between its actual and par value.[12] The corporate property can be sold, mortgaged, or transferred to a bona fide holder for value. Such powers cannot be reconciled with the idea of a trust fund. The only true meaning that this doctrine can have, is that the corporate property must be appropriated to the payment of the corporate debts before any portion of it can be distributed among shareholders.[13]

The capital stock of a corporation constitutes a basis upon which credit is given to it. Since the shareholders are not personally liable for the debts of the corporation beyond the par value of their stock, the capital stock is the only fund to which creditors can look for the payment of their debts. Creditors have the right to presume that the capital stock is fully paid in; and if the corporation holds itself out as having a capital stock of so much when in fact the shareholders have paid less than par for the stock, this is a fraud on creditors, and if the corporation becomes insolvent and there are no funds for them to look to for payment, they can insist that the shareholders must live up to their representations and pay in the remainder of their subscriptions. Fraud, actual or constructive, is the basis of this rule, and a prior creditor who has not been injured by the issue of bonus stock could not force the shareholder who has received the bonus to pay for it.[14] Nor can a subsequent creditor set aside a conveyance voidable for fraud; since he is presumed to have known the financial status of the company at the time he advanced it credit.[15] Nor can subsequent creditors with actual notice insist on payment of stock subscriptions, since they are not deceived.[16] The stock can be paid for in labor or property. Where stock is paid for in property, an honest overvaluation of the property does not give rise to an action on the part of creditors to recover from the shareholder the excess valuation; since fraud must

[10] American Exchange Bank *v.* Ward, 49 C. C. A. 611, 111 Fed. 782, 55 L. R. A. 356.

[11] Hollins *v.* Brierfield Coal & Iron Co., 150 U. S. 371.

[12] Handley *v.* Stutz, 139 U. S. 417; Clark *v.* Beaver, 139 U. S. 96.

[13] See Fogg *v.* Blair, 133 U. S. 534.

[14] Hospes *v.* Northwestern Mfg. Co., *supra.*

[15] Graham *v.* Railroad Co., 102 U. S. 148.

[16] Lea *v.* Iron Belt Mercantile Co., 147 Ala. 421, 42 South. 415, 8 L. R. A. (N. S.) 279; First Nat'l Bank *v.* Gustin Minerva Consolidated Mining Co., 42 Minn. 327, 44 N. W. 198, 18 Am. St. Rep. 510, 6 L. R. A. 676.

form the basis of such an action.[17] A gross overvaluation, however, raises a presumption of fraud, and shareholders must pay the full par value at the instance of creditors unless they can rebut it, even though the corporation itself could not have enforced payment.[18]

The property of a corporation, solvent or insolvent, bears identically the same relation to the creditors of the corporation as the property of an individual or partnership bears to the creditors of such individual or partnership. It is impressed with a trust character, only under the same circumstances and under the same conditions as would be the property of an individual or partnership. An individual, not in debt, can give his property away, provided that he does not intend to defeat future creditors. So also can a partnership under similar circumstances give its property away, and, in the absence of charter restrictions, the same thing would be true of a corporation. The remedy against a corporation, in such cases, rests upon precisely the same ground as does the remedy against an individual or partnership. And the basis of this remedy is not that the assets are held in trust for the benefit of creditors but rather that a fraud is perpetuated upon the creditors, against which equity will give relief, as readily to the creditor of a corporaton as to the creditor of an individual or partnership. When chancery once takes hold it will administer the property for the benefit of all the creditors before it; and in this way the court becomes a sort of trustee *sub modo,* but not with reference to the character of the estate.

THE EXTENT TO WHICH A JUDGMENT OR DECREE VALID IN ONE STATE WILL BE DENIED VALIDITY IN OTHER STATES OF THIS UNION.—The operation of every judgment must depend upon the power of the court to render that judgment.[1] From this it follows necessarily that when it is sought to enforce in one country the judgment of the court of another, the court of the country in which the foreign judgment is to be enforced has the right to determine whether the foreign tribunal pronouncing the judgment had lawful jurisdiction. From this elementary principle has resulted the rule of international law, that in order to found a proper ground of recognition of any foreign judgment in another country, it is necessary first to establish that the court pronouncing the judgment had lawful jurisdiction over the cause, the subject-matter and the parties.[2] This rule is applied, of course, only to those judgments to which it is desired to give extraterritorial effect, and affects in no

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[17] Coit *v.* Gold Amalgamating Co., 119 U. S. 343; Bank of Fort Madison *v.* Allen, 129 U. S. 372.

[18] Hastings Malting Co. *v.* Iron Range Brewing Co., 65 Minn. 28, 67 N. W. 652.

[1] Rose *v.* Himely, 4 Cranch 241.

[2] Rose *v.* Himely, *supra;* Roth *v.* Roth, 104 Ill. 35.